

CITY OF SAN DIEGO
M E M O R A N D U M

DATE: September 8, 2005

TO: Honorable Deputy Mayor and City Council

FROM: P. Lamont Ewell, City Manager

SUBJECT: Audit Committee Investigations

It has come to my attention that the Audit Committee has identified concerns regarding a portion of work conducted by Vinson & Elkins ("V&E") and Applied Discovery ("ADI"). I want to assure you that I have taken immediate steps to address and correct those concerns.

Two weeks ago the Audit Committee explained to me that it had questions about how data, surrounding electronic files, was handled by ADI. ADI was hired to obtain and identify electronic documents potentially relevant to the investigation. After much research, the Audit Committee was able to confirm its suspicions. Approximately 57,000 files of the 160,000 files, identified as potentially relevant, have not been reviewed. It is my understanding that ADI has stated that a "technical issue" probably caused those files to be excluded.

The failure to include those 57,000 electronic files has delayed the City's ability to provide documents to the Securities & Exchange Commission and the United States Attorney's office. This error has also cost the City money. This is clearly unacceptable. As soon as I received confirmation of the situation from the Audit Committee, we immediately developed a strategy to correct the problem. The details are included in the attached letters.

I have informed V&E that I am withholding a million dollars in payment, until these matters are resolved. This is to insure that the City will not be paying for services that were not properly delivered as expected. V&E was responsible for providing instructions to and supervising the work of ADI as part of its investigation and report to the City on disclosure related matters.

I have also informed ADI that I expect this issue to be corrected immediately, at no expense to the City. Additionally, I have instructed ADI that its work will now come under the direct scrutiny of the Audit Committee.

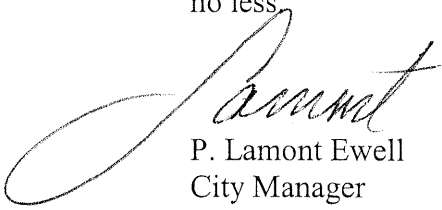
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Honorable Mayor and City Council

September 8, 2005

This is a prime example of the importance of the Audit Committee. The Committee was able to test some of the work in this ongoing investigation. Once an area was identified as potentially problematic, the City was able to immediately address and correct the situation.

I assure you that I will continue to push for the completion of a comprehensive investigation into potential matters of wrongdoing. It is crucial in order to get our audit completed by KPMG. More importantly, the citizens of the City of San Diego deserve no less.

A handwritten signature in cursive script, appearing to read "P. Ewell", is written over the printed name and title.

P. Lamont Ewell
City Manager

Attachments



THE CITY OF SAN DIEGO

September 8, 2005

Paul S. Maco, Esq.
Vinson & Elkins
The Willard Office Building
1455 Pennsylvania Avenue NW, Suite 600
Washington, DC 20004-1008

Dear Mr. Maco:

As you know, the City retained your law firm to assist in the completion of a comprehensive investigation into potential wrongdoing in matters of concern to our independent auditing firm, KPMG. A critical component of the investigation included the review of several thousand electronic files. I have just learned that approximately 57,000 files of the approximately 160,000 files identified as potentially relevant by NTI Breakwater's ("NTI") forensic analysis of select City of San Diego GroupWise email accounts were not uploaded to the Applied Discovery database ("ADI") and, as a result these 57,000 files were not reviewed by Vinson & Elkins ("V&E") as part of its work for the City.

As I understand it, San Diego Data Processing ("SDDPC") provided email boxes for City employees identified by V&E to NTI. NTI searched the email boxes using a list of search terms provided by V&E, which V&E had discussed with KPMG ("Search Terms"). NTI forwarded the results of its searches to ADI. When uploading the information received from NTI to its database, ADI used the Search Terms to search the information received from NTI again. Apparently, ADI should not have searched the data received from NTI a second time when uploading the information to its database.

ADI has stated that a technical issue likely caused the exclusion of files that NTI had identified as responsive to the Search Terms from the information that was uploaded to ADI's database. At some point the link between an email and its related attachment(s) was broken. Apparently when ADI applied the Search Terms, only files actually containing the terms were noted as responsive. Therefore, if an email contained a Search Term, but its related attachment did not, ADI uploaded only the email to its database.



Office of the City Manager

202 C Street, MS 9A • San Diego, CA 92101-3869

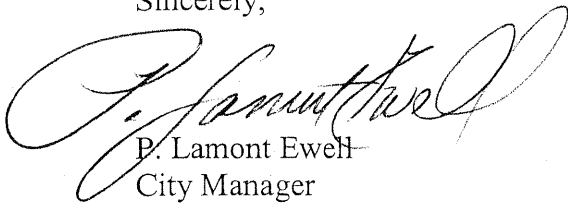
Tel (619) 236-6363 Fax (619) 236-6067

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Paul S. Maco, Esq.
September 8, 2005

The failure to include these files on the database has delayed the City's production of documents to the SEC and the United States Attorney's office. In addition, this error has caused the City to incur significant costs in having the missing files restored, and costs associated with a complete review of emails required by the Audit Committee, in addition to the attorneys' fees and expenses associated with creating and reviewing the original database.

It is my belief that V&E was responsible for providing instructions to and supervising the work of ADI as part of its investigation and report to the City on disclosure related matters. We are currently assessing the total number of hours you expended in this review to determine costs charged to the City for services not received. Until we are able to resolve this matter, I will be retaining \$1 Million of final billings from V&E until all matters are properly resolved. We will attempt to expedite this review and trust that we will be able to rely on your continued cooperation.

Sincerely,



P. Lamont Ewell
City Manager

PLE/js



THE CITY OF SAN DIEGO

September 8, 2005

Scott Nagel, Esq.
LexisNexis® Applied Discovery®
13427 NE 16th Street, Suite 200
Bellevue, WA 98005

Dear Mr. Nagel:

As you know, the City retained the Law Firm of Vinson and Elkins ("V&E") to assist in the completion of a comprehensive investigation into potential wrongdoing in matters of concern to our independent auditing firm, KPMG. A critical component of this investigation included the review of several thousand electronic files. I have just learned that approximately 57,000 files of the approximately 160,000 files identified as potentially relevant by NTI Breakwater's ("NTI") forensic analysis of select City of San Diego GroupWise email accounts were not uploaded to the Applied Discovery database ("ADI") and, as a result these 57,000 files were not reviewed by V&E as part of its work for the City.

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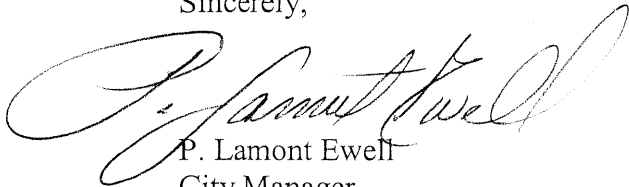


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We understand from Kroll that ADI has acknowledged these files were not uploaded to the ADI database and is working with Kroll to restore the files at no cost to the City. We would like this matter resolved promptly and fully anticipate that you will continue to work with Kroll to ensure a successful conclusion.

Sincerely,



P. Lamont Ewell
City Manager

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